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UNCLAS SECTION 01 OF 02 LILONGWE 000968

SIPDIS

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TREASURY FOR INTERNATIONAL AFFAIRS AFRICA LUKAS KOHLER

E.O. 12958: N/A
TAGS: ECON EFIN EAID ETRD PREL MI BUD FIN
SUBJECT: MALAWI'S BUDGET APPROVED

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SUMMARY

¶1. (U) Malawi's Parliament approved the FY 2004/05 budget on September 24. During the course of deliberations, Parliament added MK4.2 billion ($39 million) of additional spending, principally for HIV/AIDS programs. The deficit would remain at about MK8.5 billion ($79 million), or 4.3 percent of GDP, on a budget of MK89.9 billion ($840 million). A number of likely expenditures are not included in the budget, though these may be balanced by expected but as yet unbudgeted donor revenues. If the budget holds as written, Malawi will stay within the IMF's deficit ceiling, enabling a new IMF program and linked bilateral aid. The GOM will need both both discipline and luck to get through the November-March planting season. End summary.

MAIN OBJECTIVE: TRANSITION TO STABILITY

¶2. (U) In his address to Parliament at the beginning of the budget session, Finance Minister Goodal Gondwe described the 2004/05 budget as "transitional," on account of the huge debt inherited from the profligate spending of former president Bakili Muluzi. This recurrent expenditure will keep the government from investing enough to drive economic growth. Government's main ambition for this year, Gondwe said, is to establish the practices and mindset necessary to effective fiscal discipline and good economic governance. The goal of this budget, then, is to achieve a track record. That will lay the groundwork both for macroeconomic stability (helped by renewed aid flows) and for the fiscal soundness needed for development investment in future years.

¶3. (U) As presented to Parliament, Gondwe's budget would spend MK85.7 billion ($801 million), or about 40 percent of GDP, against revenues of MK77.2 billion ($721 million). On the revenue side, MK52 billion is domestic revenue and MK25 billion is foreign aid/grants. The deficit of MK8.5 billion ($79 million) would stay just at the International Monetary Fund's (IMF) deficit ceiling of 4.3 percent of GDP.

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PARLIAMENT EXTENDS DEBATE, ADDS SPENDING FOR AIDS
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¶4. (U) Parliament was reportedly far more engaged in debating this budget than in any previous year, adding an extra week to the normal two-week debate period. This is thanks in part to a budget seminar for members of Parliament just prior to the session, and in part to the central place the Mutharika administration has given to fiscal matters. The largest bone of contention appeared to be whether the GOM should assume donor revenues, which have been withheld for nonperformance in previous years. At the end of the session, though, the budget stands substantially as drafted. The largest allocations go to the ministries of education (MK10.6 billion), health (MK9.1 billion), and agriculture (MK7 billion). Parliament added MK4.1 billion to the National AIDS Commission budget, which will be offset by a Global Fund grant.

¶5. (SBU) Though the donor community is not enthusiastic about the size of the deficit, it is mostly satisfied with the reality of the budget. Gondwe's budget includes all but a few predictable expenditures--a distinct improvement on the previous administration's notoriously unrealistic budgeting. The budget includes allocations for fertilizer subsidies and grain buys, which have traditionally been treated as off-budget emergency expenditures. But the GOM is likely to make a few off-budget expenditures, including an MK800

million rural microfinance facility, expenses for consolidating the government in Lilongwe, refurbishment of the chief of state's residence, and a civil service wage reform package. On the other hand, the budget makes conservative assumptions on interest rates (and thus on debt service expenditures) and deliberately leaves off several likely revenue sources which are politically contentious, such as higher effective tax rates on reformed government wages.

COMMENT: LUCK STILL HAS A PART IN THIS

¶6. (SBU) While the final document has not been published, it appears that the budget is in line with the draft, which was vetted through the IMF's staff monitoring program. The big challenge for the Mutharika administration is to stay within the budgetary limits. We have a couple of reasons to think Mutharika may succeed at this.

¶7. (SBU) First, the budget does not appear to be designed to please donors. There are some hard-to-swallow expenditures, but we view them as a crucial concession to reality. The budget avoids most revenue risk and thus has some implicit upside. For instance, the possibility of new IMF aid represents a substantial windfall that would allow accelerated domestic debt retirement and a corresponding cut in debt service. Second, Mutharika has positioned fiscal responsibility and economic growth firmly at the front of his administration's ambitions. He has emphasized this issue almost to the exclusion of all others, making it virtually impossible for him to push the issue aside in case of failure to perform, as his predecessor did time after time.

¶8. (SBU) But there is still risk in the coming months. The GOM has to survive the November-March planting season, when inflation will rise because of food shortages, and foreign exchange pressure will increase. With slim forex reserves and excess liquidity in the system, a currency devaluation and an inflationary spiral are still very real possibilities. To survive the next six months, the government will have to be competent, disciplined, and lucky.

GILMOUR